

BEFORE THE  
HOUSE OF REPRESENTATIVES  
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

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RAIL COMPETITION AND SERVICE

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Mr. Chairman and members of the Committee, I am pleased to appear before you today to present the views of USDA regarding rail competition and service. As Associate Administrator of the Agricultural Marketing Service at USDA, I oversee domestic and international marketing programs for American food and fiber. Included within these program responsibilities is USDA's work on agricultural transportation.

### ***BACKGROUND ON CONCERNS***

On October 6, 2006, the United States Government Accountability Office (GAO) released a report that included observations on rates, competition, and capacity issues in the U. S. rail freight industry.<sup>1</sup> GAO found that most rail rates have declined since 1985, but that grain rates diverged from the trends of other industries. In addition, the GAO reported that the amount of grain traffic with comparatively high markups over variable cost increased notably between 1985 and 2004.

This year, the GAO released information updated to include data for 2005.<sup>2</sup> This report noted that 2005 rail rates "increased 7 percent over 2004 levels, which is the largest annual increase in the past 20 years, outpacing the rate of inflation for only the second time in 20 years." Rate changes for grain continued to outpace the rate of inflation and continued to diverge from the trends of other industries. In addition, miscellaneous railroad revenues—which include fuel surcharges—nearly tripled from \$633 million in 2004 to \$1.7 billion in 2005.

USDA, like GAO, is concerned about the possible effects of railroad market power in some regions of our nation. Consequently, USDA concurs with GAO's

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<sup>1</sup> Freight Railroads, United States Government Accountability Office, GAO-07-94, October 2006.

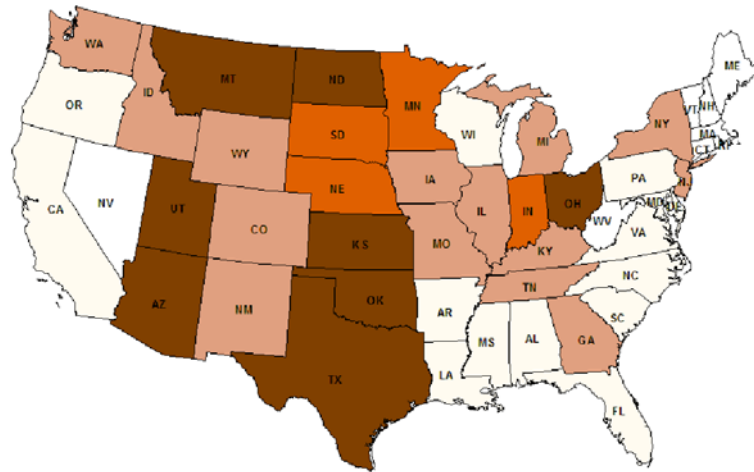
<sup>2</sup> Freight Railroads, United States Government Accountability Office, GAO-07-291R, August 15, 2007.

recommendation that the Surface Transportation Board (STB) conduct a rigorous analysis of competition in the freight rail industry. On September 13, STB awarded a contract to an independent analyst to conduct a study on railroad competition.

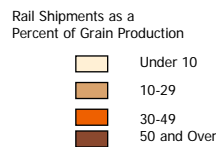
### ***AGRICULTURE AND RAIL TRANSPORTATION***

An affordable and reliable transportation network is necessary to maintain the strength and competitiveness of American agriculture and our rural communities. Rail service is a particularly important part of that network for U.S. agriculture, and it is virtually the only cost-

**Figure 1. Railroad Shipments/Production Ratio**



Source: U.S. Department of Transportation; U.S. Department of Agriculture, 2004



effective bulk shipping alternative available in many rural areas. Several states - including Arizona, Kansas, Montana, North Dakota, Ohio, Oklahoma, Texas, and Utah - rely heavily on rail services for the transportation of grains. More than 50 percent of corn, wheat, and soybeans produced in these states is moved by rail (Figure 1).

Rapid expansion of the U.S. ethanol industry could have several implications for agricultural transportation, including increasing volumes of ethanol shipments and shifting grain and oilseed marketing patterns that could occur due to changes in production and use. In 2005, rail was the primary transportation mode for ethanol,

shipping 60 percent of ethanol production (or approximately 2.9 billion gallons of ethanol), followed by trucks at 30 percent, and barges at 10 percent.

The lack of excess transportation capacity increases the sensitivity of transportation to sudden changes in transportation demand and distribution patterns. Changes in these patterns brought on by rapidly increasing ethanol production could impact rail network performance, highway congestion, and barge traffic. For example, the increased sensitivity of transportation modes became evident in the aftermath of Hurricanes Katrina and Rita in 2005, when rail had insufficient capacity to transport displaced grain barge freight and trucks could not carry the grain economically for long distances.

Rail capacity for agricultural products has been extremely tight during the last four years, for a number of reasons, both agricultural and non-agricultural. Non-agricultural factors include general economic expansion, increased international trade, increased rail-truck intermodal traffic, increased demand for coal due to high natural gas prices, high fuel prices shifting truck traffic to railroads, and new hours of service (trucking) regulations increasing rail intermodal demand. Agricultural factors include strong grain export demand, higher prices for agricultural crops, back-to-back record or near-record grain harvests, a surge in ethanol and ethanol co-product production.

### ***BENEFITS OF THE STAGGERS ACT***

The Staggers Rail Act of 1980 (Staggers Act) significantly reduced regulation in the railroad industry. Among other reforms, the Staggers Act encouraged greater reliance on competition to set rates and gave railroads increased freedom to price their services according to market conditions, including the freedom to use differential pricing. Thus, railroads are in a position to recover a greater proportion of their costs from rates charged

to shippers with a greater dependency on rail transportation. At the same time, the Staggers Act gave the Interstate Commerce Commission, and later the Board, the authority to establish a rate appeals process so that shippers could obtain relief from unreasonably high rail rates.

Railroads have benefited from deregulation. Since deregulation, the rate of return on investment for the industry has increased from an average of almost 2.5 percent during the 1970s to over 8 percent in 2005.

Shippers have also benefited from railroad deregulation. These benefits include the preservation of railroad service, rate savings, and, in many cases, improved service. Short line railroads have been able to operate profitably on many rail lines abandoned by the major railroads and have generally provided more individualized service to shippers.

As expected, the distribution of benefits has tended to favor grain producers and shippers in regions with higher levels of transportation competition.<sup>3</sup> GAO also noted that rates have not declined uniformly and that rates for some commodities are significantly higher than rates for others. Despite the overall success of the Staggers Act, agricultural producers and shippers continue to express concern about decreased rail-to-rail competition, increased rail rates, poor rail service, rail capacity constraints, and the fair allocation of rail capacity.

### ***RAIL-TO-RAIL COMPETITION***

One of the key assumptions underlying the deregulation of the rail industry was that there would be sufficient transportation competition, at least in most markets, to constrain the use of railroad market power. Not only does effective competition promote

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<sup>3</sup> John Bitzan, Kimberly Vachal, Tamara VanWechel, and Dan Vinge, *The Differential Effects of Rail Rate Deregulation: U.S. Corn, Wheat, and Soybean Markets*, Upper Great Plains Transportation Institute, June 2003.

reasonable rates and minimize the need for regulatory control, but it also encourages efficient management of railroads.

Rail consolidation also has led to a decline in competitive routes and options for some agricultural shippers. USDA recognizes that some regions may not have adequate freight traffic to support rail-to-rail competition. In such cases, mandated rail-to-rail competition could result in higher, rather than lower, rail prices. However, as a result of increased distances to grain elevators located on competing rail lines, some agricultural producers have lost the benefits of geographic rail-to-rail competition.

### ***RAIL RATES***

Small agricultural producers of grain and oilseed crops generally are considered “price-takers.” That is, they have little or no ability to influence the price they receive for their products, and therefore, are unable to pass increases in costs forward to buyers of their products. Instead, these individual agricultural producers tend to absorb any cost increases because of their lack of market power. Consequently, increases in transportation costs can result in decreased producer incomes. In turn, lower producer incomes can adversely affect the ability of individual producers to borrow funds or purchase inputs such as fertilizer and machinery, potentially reducing economic prosperity in rural areas. Higher transportation costs can also hinder the competitive position of U.S. agricultural products in highly competitive export markets.

GAO’s analysis states that although many rates have decreased, rates have not declined uniformly, and rates for some commodities are significantly higher than for

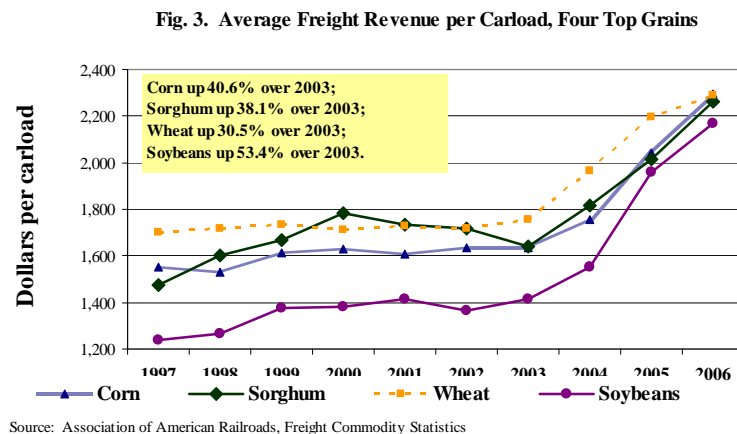
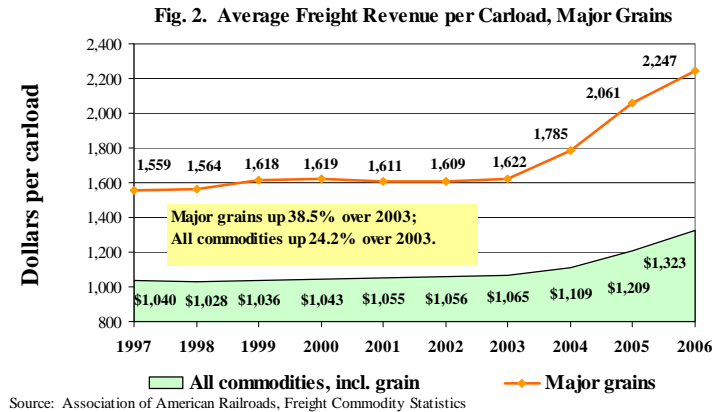
others. In fact, between 2003 and 2006, rail rates for grain shippers have increased much more rapidly than rail rates for other products. The average freight revenue per carload for major grains has increased nearly 39 percent since 2003 while the average freight revenue for all commodities (including grain) increased only 24 percent since 2003 (see figure 2).

Rates on corn, sorghum, soybeans, and wheat have gone up 41, 38, 53, and 31 percent, respectively, since 2003 (see figure 3).

Grain shippers bear a greater responsibility for car supply and other functions that railroads formerly provided. Grain shippers now incur additional costs to obtain

guaranteed car service, provide many of their own railcars, and pay increased demurrage penalties. Also, due to railroad emphasis upon unit-trains, shippers are making more significant capital investments in sidings, grain inventory, storage capacity, and loading facilities to retain cost-effective rail service.

USDA remains concerned about the percentage of grain tonnage and revenue moving at rates exceeding revenue-to-variable cost ratios of 300. The Staggers Act and



Interstate Commerce Commission Termination Act places “reasonableness” limits on rail rates while allowing the use of differential pricing. Consequently, when considering the reasonableness of a rail rate, the STB considers certain factors,<sup>4</sup> including whether the railroad is revenue adequate, evidence that may indicate a shipper is cross-subsidizing lines not used by the shipper, and how the rates compare to that paid by comparable shippers. As the railroad industry achieves revenue adequacy, those captive shippers paying rates more than 300 percent of revenue-to-variable costs expect some measure of relief from these extremely high rates.

On September 5, STB simplified the rail rate resolution process for small and medium size shipments. These simplified rules are intended to make it easier, faster, and cheaper for shippers to bring cases involving rate disputes.

### ***RAIL SERVICE***

Railroad consolidation and competitive factors have resulted in situations in which a single railroad sets the terms of rail service – even when those service terms may not best meet the present and future needs of many agricultural shippers. At the same time, the changing nature of the grain transportation market has resulted in changes in the structure of rates and services. As some grain elevators have become equipped to handle large unit trains, for example, railroads have offered discounted rates to such elevators to reflect the railroads’ lower costs of providing unit-train service. Some farmers have gained from these discounts, while others, such as those selling smaller quantities of grain with specialty characteristics or niche market uses, have been disadvantaged.

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<sup>4</sup> The Long-Cannon factors direct the STB to give due consideration to (1) the amount of traffic which is transported at revenues which do not contribute to going concern value and the efforts made to minimize such traffic; (2) the amount of traffic which contributes only marginally to fixed costs and the extent to which, if any, rates on such traffic can be changed to maximize revenues from such traffic; and (3) the carrier’s mix of rail traffic to determine whether one commodity is paying an unreasonable share of the carrier’s overall revenue.



Agricultural producers and shippers have suggested that in some instances Class I railroad service terms may be at odds with their obligation as common carriers. Despite the retention of the Common Carrier Obligation<sup>5</sup> in the Interstate Commerce Commission Termination Act of 1995 (ICCTA), some smaller shippers perceive they have lost reliable and timely carload service while others have been required to meet railroad volume requirements to receive rail service.

The allocation of empty railcars between smaller shippers and shuttle-train shippers is an issue of importance to smaller shippers. Agricultural shippers have often voiced concerns to USDA regarding grain car allocations that seemingly favor shuttle shippers. Although the move to shuttle trains may reflect market efficiencies, public vigilance is appropriate to ensure that shippers in corridors without extensive transportation competition have reasonable access to markets.

### ***CONCLUDING REMARKS***

USDA and all interested and affected parties should continue to work together to ensure that rail transportation is affordable and reliable for the nation's grain shippers. USDA believes that healthy competition is essential for encouraging railroads to improve customer service, preserving the economic vitality of the railroad industry, and for protecting shippers from excess market power and unfair rail rates.

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<sup>5</sup> The Common Carrier Obligation requires a for-hire carrier to serve the general public at reasonable rates and without discrimination.